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No. 425

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CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner*

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

MOTION OF STATE OF TEXAS FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE

May It Please the Court:

The undersigned, Attorney General of the State of Texas, respectfully moves this Honorable Court for leave to file on behalf of the State of Texas the accompanying brief in this case as *amicus curiae.*

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.

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BRIEF OF STATE OF TEXAS AS AMICUS CURIAE

Preliminary Statement.

The petitioner, as the holder of oil and gas leases from the State of Texas upon part of the State's public domain, has brought this suit to recover income taxes levied by the United States upon its income from those leases. It asserts that, as an agency chosen by the State to produce the State's oil and gas, its income is exempt from these taxes.

The State of Texas is interested in preserving the freedom of its lessees from control by the Federal government through taxation or otherwise, as the State has the right to produce its own oil and gas, through lessees or in any other manner it deems proper, without any in-

terference on the part of the United States government. In addition, a decision in this cause in favor of the petitioner will affirmatively establish the exemption of its lessees from these income taxes with the resulting advantage to the State in granting future leases through larger cash bonuses and greater reserved royalties.

In view of these considerations the State is interested in this cause being decided in favor of the petitioner, and is filing this brief.

Argument.

Preface to Argument

As the petitioner in its brief has thoroughly discussed the material points and applicable decisions, we will not refer to them in detail. The State, however, approves and supports to the fullest extent the position taken by the petitioner.

I.

Petitioner and similar lessees of the State's lands are agencies chosen by the State to produce the State's minerals, and as such instrumentalities their compensation for their services to the State by way of income from the leases is exempt from the Federal income taxes.

The lands embraced in petitioner's leases have always been a part of the public domain of the State and its predecessor governments. They were a part of the lands dealt with in the contract and agreement between the United States and the Republic of Texas, in which it was stipulated that Texas should become a State under the express guarantee that it should "retain all its va-

cant and unappropriated lands * * * to be disposed of as said State may direct."

Under both this treaty and the Constitution of the United States the Federal government has no power to impede or hinder the State in the enjoyment of all its rights as the owner of its public domain, or diminish those rights in any manner. These particular lands have little value except for their minerals. Because of this fact no one has applied to purchase them during the long time the Republic and State of Texas has owned them. They became valuable only when it was discovered that they contained oil and gas. If the Federal government may interfere with the State's realizing upon these minerals, then it may interfere with the State in enjoying its only interest in these lands that is of substantial value. But we deem it so clearly established that the State is not subject to this control that no one will seriously contend to the contrary.

The State, in the exercise of its own unrestricted discretion, may choose the method of having its minerals produced. It has merely followed the usual and customary practice of the ordinarily prudent landowner of having them developed by lessees, who incur all the risk and expense of exploration and production. The State's royalty portion of the oil, delivered to the State without hazard or cost on its part, is worth more to it than all the oil below the ground. These services will not be performed by anyone without compensation, and this compensation to the lessees consists of their net income from the leases.

This Court has consistently held that oil and gas lessees of Indian lands in Oklahoma are agencies of

the United States government, and as such agencies may not be taxed by the State of Oklahoma. Choctaw, Oklahoma & Gulf Railway Company v. Harrison, 235 U. S. 292 (1914); Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522 (1915); Howard v. Gipsy Oil Company, 247 U. S. 503 (1918); Large Oil Company v. Howard, 248 U. S. 549 (1919); Gillespie v. Oklahoma, 257 U. S. 501 (1921); Jaybird Mining Company v. Weir, 271 U. S. 609 (1925).

Since The Collector v. Day, 11 Wall. (78 U. S.) 113 (1870), the decisions of this Court have held that the same reasons for exempting Federal agencies from State taxation require that the instrumentalities of the various States shall be equally freed from the burden of Federal taxation. In the sphere of its reserved activities the State of Texas as well as all other States of the Union is as independent of the general government as that government within its sphere is independent of the States. Not only is this true as a necessary corollary to the United States Constitution. but, as to the public domain of this State, it has been expressly recognized in the above mentioned treaty between the United States and the Republic of Texas.

The State in this case is merely invoking, for the protection of its own constitutional rights and of its agencies, the same principles that were applied to preserve the rights and powers of the Federal government and its instrumentalities from encroachments by the State of Oklahoma, and that have been invoked against the State of Texas in various cases, for example, Telegraph Company v. Texas, 105 U. S. 460, and Graysburg Oil Company v. Texas, 278 U. S. 582. It must always be

borne in mind that this exemption of governmental instrumentalities is primarily for the preservation of the State or Federal government's rights and powers, and not solely for the private benefit of the agency. In giving effect to this exemption of a Federal agency the Supreme Court of Texas, in State v. Texas & Pacific R'y Co., 100 Tex. 279, 284, pointed out that, because of this fact, the agency had no power to waive it.

The exemption of governmental agencies from taxation by another government has become such an integral part of our constitutional law since McCulloch v. Maryland, 4 Wheaton 316, that only by an amendment to the Constitution itself may this fundamental principle be changed or altered. It has been invoked by this Court in numerous cases in recent years in which State taxes have been held to be void. The vitality of the principle has been particularly emphasized in the recent case of The Macallen Company v. Massachusetts, 279 U. S. 620, in which this Court reviewed its early decisions and reaffirmed them in all respects.

As the Supreme Court of Texas said in State v. Texas & Pacific R'y Co., *supra*, p. 284, the principle is so well established that if there is to be any change,

> "the remedy, if there be one, is not with the legislatures, or the judiciary of the States, nor now, perhaps, with the Federal judiciary, but with the Congress of the United States."

That case dealt with Federal agencies, and their exemption may be waived only by the Congress. In the case of a State's agencies the exemption may be waived only by the State Legislature creating them.

As respondent has in the lower courts sought to justify

these taxes under Theisen v. Robison, 117 Tex. 489, we will refer to it briefly. The only point decided in that case, and the only one upon which it is binding upon this Court, was that the 1917 and 1925 Leasing Acts in authorizing these leases did not violate the provision of Article VII, Section 12, of the Texas Constitution that the lands set aside for the University of Texas should be "sold." The question of whether these lessees were such agencies of the State that they may not be taxed by the United States was not before the Court in any way. Its decision therefore is not controlling, and has no bearing upon, that point, which is the one presented to this Court in this case.

The Supreme Court of Texas simply held that, as it construed an ordinary oil and gas lease as passing, immediately upon its execution, the title to the minerals in place to the lessee, these leases likewise passed such title to the lessees; that one meaning of a sale is a conveyance of a title; and as these leases were a conveyance of this title, they were sales of a sufficient character to comply with the above mentioned provision of the Texas Constitution.

To contend that the mere passage of title to the oil in place to the lessee deprives the State of its right to have these lessees, whose leases are substantially similar in all respect to the ordinary commercial oil and gas leases and are subject to the same rules of law (Greene v. Robison, 117 Tex. 516, 5[illegible]5-6), free from Federal control, is to give effect to form and waive aside substance. The determining factor is, not by what name the transaction between the State and the lessee upon the execution of the lease is called, but the effect of the tax. Whether

the leases are termed sales or not, the effect of the tax is the same. Its interference with the enjoyment by the State of its sovereign ownership of its minerals is just as great and just as unauthorized.

The United States has no power or right to levy any tax upon the leases themselves, and it is fundamental that where the principal is absolutely immune from interference, any tax upon the net income therefrom is void. Gillespie v. Oklahoma, 257 U. S. 501. As the leases themselves are immune from interference, the income of the lessees, the State's agencies, therefrom is also immune.

The State of Texas, therefore, submits that the United States has no power, right or authority to impede the State of Texas in this manner in exercising its sovereign right to have its oil and gas resources produced for its benefit in such manner as the State in its own uncontrolled discretion deems proper or advisable, and any such attempt is derogatory to this State's dignity, subversive of its powers, and repugnant to its paramount authority.

II.

By Section 27 of the 1917 Leasing Act the State of Texas did not waive its fundamental right to have its lessees at all times free from interference or control by the United States. That section referred only to taxation by the State and its subdivisions and did not embrace Federal taxation.

This section is thoroughly discussed by the petitioner in its brief, and we will not take it up in detail. We desire to reiterate briefly certain controlling principles in connection with that section.

If it is a waiver of the exemption of the State's lessees from Federal taxation, then the State has waived its sovereign right to have its agencies subject to control by no government but its own. As such construction would result in a surrender of this sovereign right of the State, the section will be construed in favor of the State. As the section does not specifically include Federal taxation, it will be construed as excluding it, and thus preserving the full sovereign rights of the State.

The State's agencies are exempt from taxation by the Federal government unless it clearly and unmistakably consents to such taxation. As Section 27 does not refer to the Federal government, this section may not be construed as such consent by the State.

The intent of the legislature and the purpose sought to be accomplished and the circumstances surrounding the origin of Section 27 as Section 28 of the 1913 Leasing Act, demonstrate that the section was intended solely to refer to taxes levied by the State and its subdivisions. As pointed out by the petitioner's brief, this section originated in the 1913 Act when oil lessees were litigating with the State's taxing authorities the question of whether oil and gas leasehold estates were such property as was taxable under the general tax statutes. If in the litigation then pending, the State Courts had held such leases were not taxable, and no specific provision had been made in the Leasing Acts as to taxation, the lessees of the State lands would have escaped the payment of all taxes both to the State and to the counties and other subdivisions. To remove the possibility of this situation arising this Section 27 was written into the 1913 Act as Section 28.

This question was especially important as regards taxes to be collected by the local counties in which the University lands were situated. In some of these counties there are very large tracts of State public lands. As they are part of the public domain, they are not subject to county taxes. This results in the taxes for county purposes upon privately owned lands in these counties being higher than they otherwise would be. These counties have for many years demanded that they be relieved in some way from this situation.

As early as 1910 the counties in which prison farms were located had obtained a provision that those farms should be subject to taxes for county purposes, the taxes to be paid only out of revenue from the farms. This was provided for in 1910 by Chapter 5, page 122, Acts of Fourth Called Session, Thirty-first Legislature. This Act now appears in Article 7150 (4) of the Revised Civil Statutes of 1925, and is as follows:

> "* * * where the State of Texas has or may acquire and own land for the purpose of establishing thereon State farms and employing thereon convict labor on State account, the penitentiary board or board of penitentiary commissioners, or other officers of the penitentiary having the management of the same, shall render said land for taxes to the tax assessor of said county; and the taxes on same shall be assessed and collected in the manner required by law for the assessment and collection of other taxes; provided, that said taxes shall be assessed and collected for county purposes only; and said county taxes shall be paid annually out of the revenue derived from such State farms respectively by the officer having the management thereof, and same shall be charged to the expense account of operating such farm. No debt shall be created against the general revenue of the State in case of the failure to pay

said taxes out of the revenue of any such farm. In arriving at the amount to be paid in taxes to the counties the value of the land only shall be considered, and not the value of the buildings and other improvements owned by the State and situated on said land."

The counties in which University lands are situated finally obtained in 1929 the submission of a constitutional amendment providing for the State to pay the counties, out of the general revenues of the State, taxes upon these lands. House Joint Resolution 11, Laws of 1929, p. 714, Regular Session, Forty-first Legislature, submitted to the voters at the general election held in November, 1930, an amendment to Section 16 of Article VII of the Constitution, dealing with University lands, so as to cause Section 16 to read as follows:

"'Sec. 16. All land mentioned in Sections 11, 12 and 15 of Article VII, of the Constitution of the State of Texas, now belonging to the University of Texas shall be subject to the taxation for county purposes to the same extent as lands privately owned; provided they shall be rendered for taxation upon values fixed by the State Tax Board; and providing that the State shall remit annually to each of the counties in which said lands are located an amount equal to the tax imposed upon said land for county purposes'."

This amendment was duly adopted at that election.

These counties have finally the right to tax these lands themselves for local purposes, this burden being borne by the State as a whole. In 1913, however, they were losing large amounts of taxes they otherwise would have collected if the State lands had not been located in their boundaries. This was an additional and compelling reason why the legislature, in writing the 1913 Leasing Act,

specifically provided the leases on these lands should be subject to taxation for the benefit of the counties, and did not leave the question subject to the result of litigation then pending between oil lessees and the taxing authorities.

Furthermore, as pointed out by the petitioner, the 1925 and 1929 Leasing Acts do not contain any provision similar to Section 27 of the 1917 Act. This section was omitted because by 1925 the Supreme Court of Texas had definitely held oil and gas leases were taxable under the general tax acts. If the legislature had intended to include Federal taxation in Section 27, it would have carried it forward in the two subsequent laws, as it would have no purpose in subjecting lessees under the 1917 Act to taxation by the Federal government and not doing likewise as to those under the other two laws. Such a situation would be wholly unfair to the former class of lessees, and would subserve no purpose of the State at all.

We submit therefore that Section 27 has no application in this case.

Conclusion.

We respectfully submit that the levy of these income taxes is an invalid interference with the right of the State of Texas to have its oil and gas produced for its benefit and is unauthorized, and pray that the judgment of the Circuit Court of Appeals in this cause be reversed and that of the District Court be affirmed.

Respectfully submitted,

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Attorney General of the State of Texas.
Fred Upchurch,
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